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HOLBORN™

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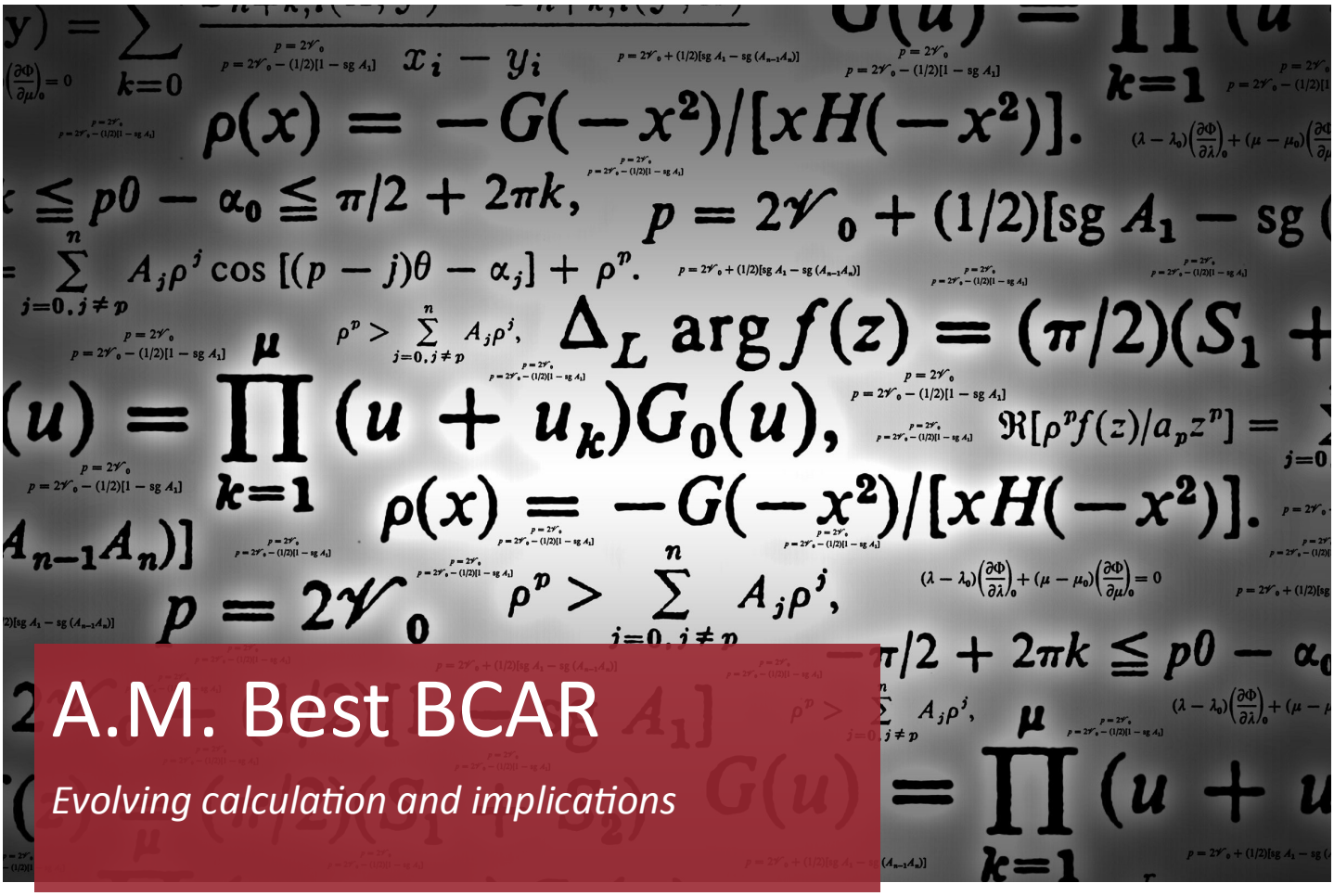
ViewPoint

Analyzing Industry Issues from an Independent Perspective



A.M. Best BCAR

Evolving calculation and implications

***On November 14, 2016 A.M. Best released** an update on the BCAR* calculation. Following a commentary period that ended in June 2016, Best analyzed the industry feedback. The response and discussions led to a number of key changes to the original calculation in the draft BCRM and P/C BCAR calculation, summarized below:

- **Value at Risk (VaR)** confidence intervals of 99.8 and 99.9 (500- and 1000-year return periods) have been replaced with 99.6 (250-year return period) in the BCAR calculation. The 99.8 (500-year return period) confidence interval will still be calculated but will only be used for the ERM assessment building block and not for BCAR.
- **Net catastrophe exposure** will no longer lead to a full 100% capital charge. The charge for net catastrophe exposure will now be included within the covariance adjustment, to recognize the inherent diversification from non-cat risks.

> *"....industry feedback...led to a number of key changes to the original calculation of...BCAR..."*

- **Assessment of Balance Sheet Strength,** the first building block within the BCRM, will incorporate an excess capital buffer. To attain the highest classifications of "Strongest" and "Very Strong," rated entities will need to maintain capital levels above the buffer at the 99.6 VaR, with preliminary thresholds shown here:

VAR Confidence Level (%)	BCAR	BCAR Assessment
99.6	> 25 at 99.6	Strongest
99.6	> 10 at 99.6 & ≤ 25 at 99.6	Very Strong
99.5	> 0 at 99.5 & ≤ 10 at 99.6	Strong
99	> 0 at 99 & ≤ 0 at 99.5	Adequate
95	> 0 at 95 & ≤ 0 at 99	Weak
95	≤ 0 at 95	Very Weak

- The **charge for reinsurer concentration** has been removed from the BCAR calculation. The Balance Sheet Strength (BSS) assessment will still consider reinsurer concentration, as well as reinsurance dependence, quality of reinsurance, and other qualitative factors.

Overall, practicality and transparency have been improved by providing the resultant "stochastic-based factors" emanating from the simulation modeling underlying the BCAR model. In making these factors available, A.M. Best will enable analysts to perform pro forma scenarios to measure the impact of strategic business decisions concerning growth, profitability, asset mix, reinsurance, and all other capital charges. Holborn works closely with clients to model, measure, and test the effect of adjusting these risk factors on BCAR.

Holborn's Supporting Analytics

During the comment period and in consultation with several clients, Holborn expressed concerns to Best's over the VaR calculation and full capital charge for cat risk. **Scott Rosenthal, SVP & Head of Actuarial** commented: "We are very pleased to see A.M. Best's response to the concerns of the industry. These meaningful changes to the draft methodology will improve the model's reliability by reducing the volatility in the tail and reflecting the natural diversification benefit of non-correlated insurance risks."

> *"We are very pleased to see A.M. Best's response to the concerns of the industry…"*
>
> *- Scott Rosenthal, SVP & Head of Actuarial*

In addition to modeling any possible changes to BCAR, Holborn is helping clients to quantify BCAR tolerance and evaluate their own view of risk in the context of growth strategies. Holborn's proprietary *OptimEyes* provides a comprehensive and realistic approach to catastrophe portfolio optimization (for both growth or depopulation situations).

OptimEyes marries strategic and risk tolerance objectives, while providing an allowance to include some risks that don't meet specific criteria (at the selection of the client) to better resemble the commercial decisions primary carriers make every day. The analysis is fully integrated into Holborn's exposure management tool, *Eye-In-The-Sky*℠.

A.M. Best estimates another comment period until March 2017, with formal roll-out of the new BCAR calculation schedule for mid-year 2017.

Reach out to your Holborn contact to continue the discussion and find out how our tools and analysis can support your business.